The annuity advantage: Part 2

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If you invite an actuary to a 65th birthday party-- I wouldn't actually recommend it-- but suppose you do that. And as you're blowing out the candles, you ask him, how long am I going to live? How many more times do I get to blow out the candles? The truth is he won't be able give you an answer.

The average person turning 65 today, if you average over gender and wealth and health, the average is about 21 years. So on average, you can expect to live to about 85 or 86. The problem is that there's a 5% chance that you'll live to age 96 or above.

And so he won't know the answer to that. But if you ask him instead of the 10,000 other people who are celebrating a 65th birthday today, how long will they live? Suddenly, he'll have the answer. Oh, it's about 21 years.

And that, in its essence, is the advantage that an insurance company has in using annuities to provide lifetime income. Because an insurance company can just average over average lifespans, while an individual has to be 95% sure that their money will last-- that they don't essentially outlive their money.

And that means that as an insurance company pays out, it can actually afford to pay out a bigger annual payment than an individual could pay themselves if they wanted to be sure they didn't run out of money. And that's the basic advantage of an annuity.

The second advantage that an annuity has over somebody who does it themselves is that you can average not just over different lifespans but actually over different market cycles. If you retire at the end of a bear market, that is actually a pretty good time to retire. Because as the market begins to move up again, the value of your portfolio may move up even as you pull money out.

But if you retire at the end of a bull market when stocks are very high, the danger is that stocks could fall enough in the first few years of your retirement that you actually run out of money. But an insurance company offering annuities can actually average over market cycles. So they are invested throughout your retirement, unlike the individual investor who will be pulling money out as a retirement proceeds.

In the past-- going back to 1950-- we've seen very good returns from both stocks and bonds. And that means that if you've been taking an income in retirement, either because you did it yourself or from an annuity, you could get a pretty good return on your money. But going forward, we believe that the returns on both stocks and bonds will be much more modest than they have been in the past.

That means that the extra income that you can get from an annuity-- because an annuity company can average over market cycles and doesn't have to worry about markets falling sharply at the start of retirement-- that extra money is that more important to a retiree today.

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